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C O N F I D E N T I A L SECTION 01 OF 02 YEREVAN 000150

SIPDIS

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TAGS: ECON EFIN EINV ETRD AM
SUBJECT: ARMENIANS ANTICIPATE NEAR-TERM DEVALUATION OF CURRENCY

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Classified By: Amabassador Marie Yovanovitch. Reason 1.4 (B/D)

SUMMARY

¶1. (C) There appears to be increasing panic among the Armenian public and financial institutions concerning an imminent devaluation of the Armenian Dram (AMD). Armenians are increasingly moving their money into dollars, knowing that the CBA cannot continue to support the AMD indefinitely. This is forcing the CBA to devote even more of its foreign reserves to preventing just such a decline. The USD is already trading on the black market slightly above the official exchange rate, and banks and forex kiosks have both at times refused to sell dollars or imposed barriers to their availability. Some banks are also reportedly asking customers to redenominate outstanding loans into USD. With the passing of the March 1 commemoration of last year's post-election crackdown, perhaps one impediment to a major adjustment has now been removed. End Summary.

INCREASING FOREX INTERVENTION

¶2. (C) Given Armenians' memories of previous currency collapses, public confidence in the AMD has long been shaky, despite its appreciation from approximately 500/USD in 2005 to 305/USD at present. The onset of the global economic crisis has again undermined public confidence in the currency and prompted a movement back to the more reliable USD. The CBA, hoping to bolster confidence in the AMD and forestall a massive panic-based devaluation, has accelerated its forex intervention in recent weeks; it has spent at least USD 400 million of Armenia's forex reserves to-date defending the AMD, of which nearly USD 150 million has been spent since February 16. On some recent days the CBA has spent over USD 30 million defending the AMD. The CBA's foreign reserves, which were approximately USD 1.5 billion in September, now amount to approximately USD 800 million, less than the CBA's target balance of three months' worth of imports.

¶3. (C) The CBA has also reportedly issued a directive to banks not to sell USD for more than AMD 307, and is selling USD to the banks at 305-306. Reports of a black market in currency exchange are also surfacing, with a current "black market" rate of approximately AMD 315/USD. We also received secondhand reports through our local staff of CBA calls to various commercial banks during the weekend of February 28/March 1 urging them to continue selling dollars in the market, so as to avert a consumer panic.

RE-DOLLARIZATION

¶4. (C) The Armenian public does not appear convinced by the CBA's efforts to preserve confidence in the AMD, and likely understands that its strategy of protecting the AMD is not sustainable. Much of the Armenian public still uses the USD as a reference currency, and concern about a collapse of the AMD appears to underlie a movement into dollars in recent months: Approximately USD 105 million in bank deposits were converted from AMD to USD in December--seven percent of total deposits--the last month for which figures are available. The increase of dollar deposits in Armenian banks has led to bank loans being more readily available in USD than in AMD. We also have received several reports of banks calling in customers to pressure them to convert outstanding loans from AMD to USD, transferring the foreign exchange risk to the borrower. (Comment: In fact, it is less a transfer of risk than forcing the borrower to assume one. A bank that takes in AMD deposits and loans out AMD faces no forex risk, though it will still see the value of those Drams decline against the USD; this seems more like an opportunistic ploy. End Comment).

CURRENCY SPECULATION

¶5. (C) In order to protect themselves against a complete collapse of the AMD, many Armenians -- including large numbers of our own staff -- are converting their Drams into dollars, putting further pressure on the AMD and forcing the CBA to intervene ever more aggressively to sustain its value. Some amount of speculation is also inevitable: One Embassy FSN has reported taking out cash advances against his credit card, converting the AMD to USD, and holding the USD in anticipation of a devaluation of the AMD, earning a

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potentially tidy profit on the exercise. While there is considerable downside risk if the AMD instead appreciates, confidence is high that this is a low-risk bet.

¶6. (C) Over the February 28/March 1 weekend embassy staff reported spending hours in bank lines, visiting multiple banks, and calling in favors from relatives and friends in the banking sector in order to be able to convert more drams into dollars than banks were officially allowing. Many banks refused to convert drams to hard currency (in cash or into hard currency-denominated accounts) or imposed limits of USD 200 - 1000 per transaction. At least one bank even refused to convert dram accounts into dollar accounts, one FSN reported; the inevitable result is that she withdrew all her dram from the bank. Emboffs observed long lines at banks that had not shut down currency exchange transactions.

ENERGY PRICES ALSO ON INCREASE

¶7. (C) Expectations of an imminent collapse of the AMD are rising just as the GOAM announced on February 27 long-anticipated price increases of 20 percent for gas and electricity to residential customers. This increase is largely the result of the new contract negotiated with GazProm last fall, which increased the price to USD 154 per thousand cubic meters, up from the current rate of USD 110/tcm. Natural gas, which is priced in USD, generates approximately 25 percent of Armenia's electricity. Therefore, these tariffs are likely to increase yet again should there be a significant decline in the AMD.

HOW LONG CAN IT GO ON?

¶8. (C) At its current burn rate, the CBA's forex intervention can only continue a few more weeks, less if

its rate of intervention accelerates in response to increasing numbers of Armenians converting their AMD to USD. Some had speculated that the CBA will continue this strategy until shortly after March 1, the one-year anniversary of the post-election crackdown that left 10 persons dead. Now that this date has passed, the GOAM may soon be ready to yield to the inevitable. Some observers seem to have pinned their hopes on the expected Russian USD 500 million financial credit to stabilize the currency market, but when or whether that funding will become available to the GOAM remains an open question.

COMMENT

¶9. (C) The devaluation of the AMD threatens to become a self-fulfilling prophecy, as a lack of confidence in the currency prompts Armenians to move their savings into USD, putting additional pressure on the AMD and forcing the CBA to expend ever-increasing amounts of its foreign reserves to sustain the AMD's value. There is no easy way out of this situation, but while the CBA's desire to prevent a panic among the public by supporting the AMD is understandable, it would have been more prudent to have managed a gradual decline of the AMD, rather than to risk a major and sudden collapse. End Comment.

YOVANOVITCH